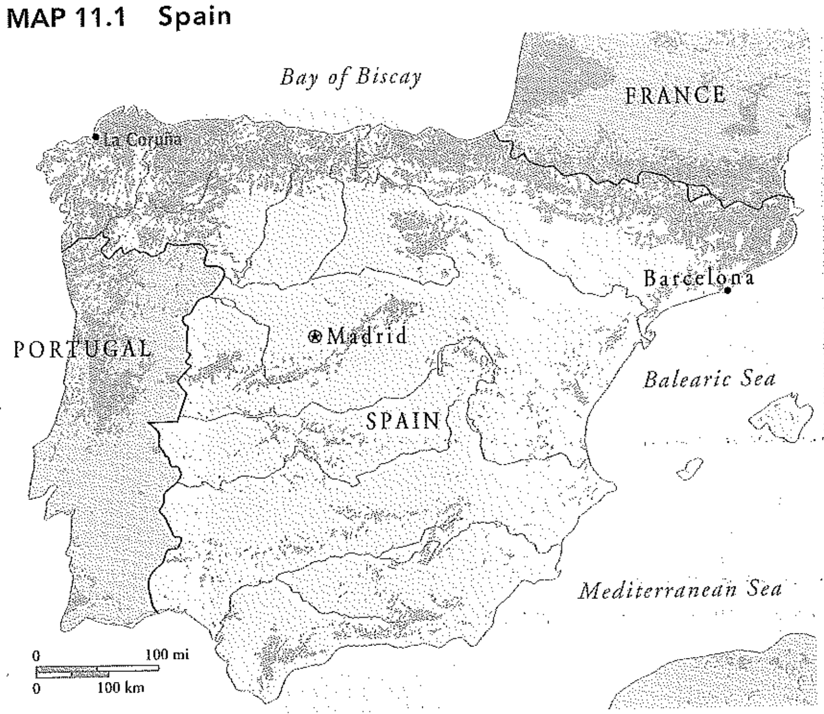
CASE Value Creation in the Global Apparel Industry

Strategy in the global apparel industry is a combination of design, production, buying, and distribution conditions.[1] Historically, national retailers outsourced apparel production, via global brokers, to thousands of small apparel makers. The typical apparel manufacturer, usually located in a low-wage country, is a small-scale operation that employs a few to a few dozen workers. In a labor-intensive process, workers make specific pieces of clothing, often in a narrow range of sizes and colors. These pieces are then integrated with the output of hundreds of other such companies spread across dozens of countries. As more countries make more specialized products—for example, one factory makes zippers, one makes linings, one makes buttons—multinational trading companies perform as cross-border intermediaries and supervise the assembly of component pieces into finished goods.

MAP 11.1 Spain



Zara is headquartered in La Coruña, in the extreme northwest corner of the country. Contemporary Spain increasingly looks to its growing textile and apparel industry, which has made the country an international center for the fashion business.

Once assembled, finished goods are shipped to apparel retailers. Increased speed and flexibility in responding to market shifts was a constant concern for apparel retailers. Therefore, they pushed multinational trading companies to improve coordination between themselves and overseas factories. Planning collections closer to the selling season, testing the market, placing smaller initial orders, and reordering more frequently let retailers reduce forecasting errors and inventory risks.

The final links in this chain are markets and customers. Although there is overlap among countries, local customers' preferences had traditionally varied. For example, the British seek stores based on social sensitivities, Germans are value conscious, and shoppers in the United States look for a mix of variety, quality, and price. Collectively, these conditions create a buyer-driven chain in the global apparel industry that links fragmented factories, global brokers, dispersed retailers, and local customers.

Globalization is changing these relationships. Traditionally, industry wisdom spurred firms to choose a "sliver" of a particular activity—to make zippers, manage logistics, focus on store design, or cater to customer segments—instead of trying to create value across several different activities. The standard of "do what you do best and outsource the rest" prevailed throughout the global apparel industry.

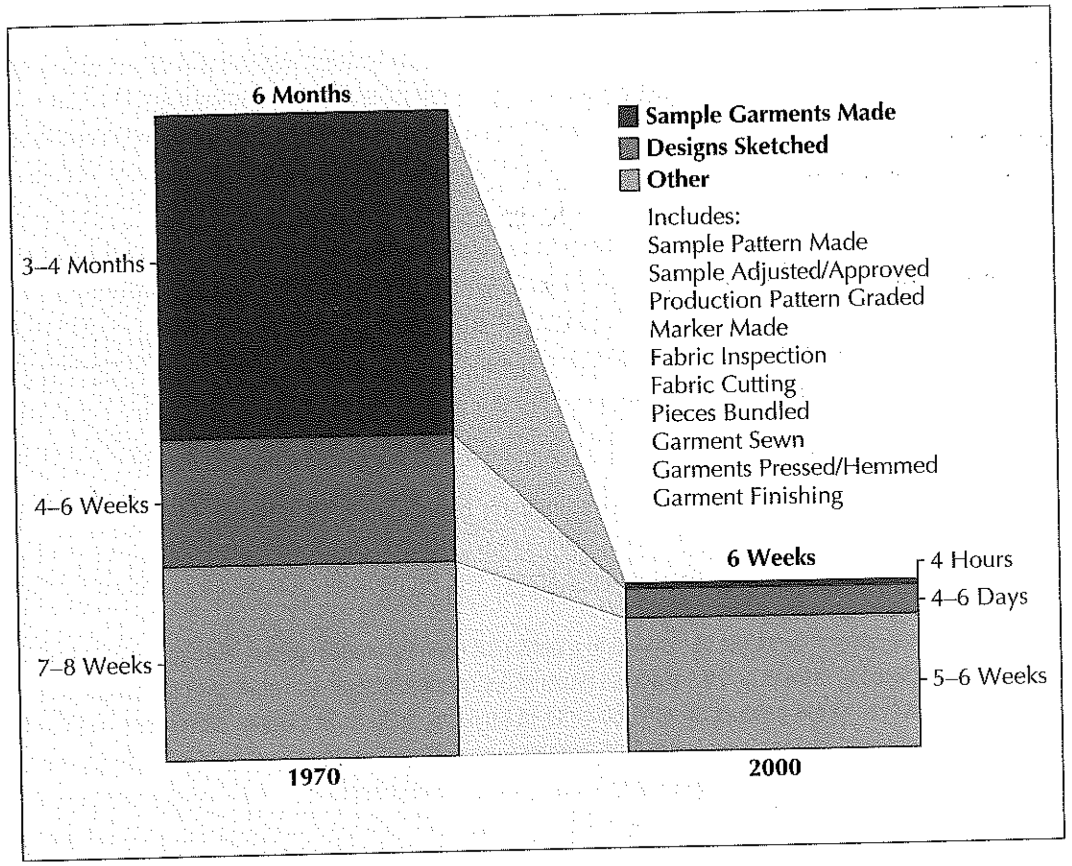


FIGURE 11.1 Cycle Time in the Global Apparel Industry

In the apparel industry, as in many other industries, globalization has brought changes that open options for players in the market. For example, innovations in technology, sourcing, and production let apparel makers steadily compress by the *cycle time* required for value activities. Contracting the time that elapses from the beginning to the end of a process improves effiencies and boosts profits.

Source: Adapted from Zara company documents.

Today, reductions in tariff barriers, integration of markets, and improving communications create new industry standards and strategic choices. A compelling example is the compression of cycle times in the apparel-buyer chain (see Figure 11.1). In the 1970s, getting a garment from the factory to the customer took six months. In 2009, it takes, on average, anywhere from nine months down to about six weeks to run this cycle. However, for one firm, Zara, it takes less than two weeks. By rejecting conventional standards, Zara has redefined the relationship among industry structure, company strategy, and firm performance.

Who is Zara? First, some demographics on Zara. In addition to Zara, Inditex, the parent corporation, also ran seven other retail chains, such as Bershka and Massimo Dutti, from its headquarters in Artexio, near La Coruña, a midsize city in northwest Spain (see Map 11.1). The Inditex Group employs about 90,000 people, half of them in Spain and the rest in the various countries where it operates. The company workforce is young (the average age is 26) and female (besides representing almost 83 percent of employees, women hold more than half of the executive, technical, and managerial positions). Inditex's revenue was $14.1 billion for 2008, just behind the worldwide leader Gap's $14.5 billion. International sales accounted for 66 percent of total sales, and 85 percent of its total retail surface area of its 4,264 storesfronts worldwide was outside of Spain; it planned to open about 450 new stores worldwide in 2009. The market acknowledged the company's performance. From June 2004 through March 2009, Inditex's stock price appreciated more than 60 percent while that of Gap fell 35 percent. In 2007, Inditex was named Global Retailer of the Year by the World Retail Congress.

Zara was the flagship of the Inditex Group. The first Zara shop opened its doors in 1975 in La Coruña. Zara now has a network of 1,292 stores spread across 72 countries. Zara uses an innovative strategy to power its global performance, integrating infotech, fashion, and e-business to make and move sophisticated clothing at appealing prices—as one analyst noted, "Armani at moderate prices." Zara translates the latest fashion trend from a catwalk in Paris to its store shelves in Shanghai in as little as two weeks versus the industry standard of six months. Moreover, Zara creates new designs in between fashion seasons to accommodate the tastes of fickle customers. In so doing, Zara's strategy questioned historic ideas of creating value in the global apparel industry.

Understanding Zara's success requires understanding its competency to configure and coordinate value activities. Standouts include its approach to creating value in design, production, logistics, distribution, and retailing activities.

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DESIGN

Zara rejects the idea of conventional spring and autumn clothing collections in favor of "live collections" that are designed, manufactured, and sold almost as quickly as customers' fleeting tastes—no style lasts more than four weeks. Zara's 200 or so designers monitor market events, fashion trends, and customer preferences in designing about 11,000 distinct items per year compared with 2,000 to 4,000 items by rivals.

Designers get ideas from store managers, industry publications, TV, Internet, film content, and trend spotters who focus on university campuses and nightclubs. Zara's so-called slaves-to-fashion staff is quick to snap digital pictures at couture shows and immediately reproduce the looks for the mass market.

Zara does not develop products to respond to a particular country's requirements. Management believes that the convergence of fashion and taste across national boundaries endorses its strategic bias toward standardization. However, some product designs do cater to physical, cultural, or climate differences—smaller sizes in Japan, special women's clothing in Arab countries, and different seasonal weights in South America. Still, about 85 percent of the basic designs sold in Zara stores are standardized.

SOURCING

Zara uses headquarters staff and purchasing offices in Barcelona, Beijing, and Hong Kong to acquire fabric, other inputs, and finished products from suppliers in Spain, India, Morocco, and the Far East. Linked into Zara's network, suppliers coordinate their production with Zara's projections. About half of the fabric purchased is "gray" (not yet dyed) to update designs quickly. José Maria Castellano, Inditex's CEO, explains, "We have the ability to scrap an entire production line if it is not selling. We can dye collections in new colors, and we can create a new fashion line in days."

PRODUCTION

Like its rivals, Zara sources finished garments from suppliers in Europe, North Africa, and Asia. However, unlike its rivals, Zara employs more than 15,000 people to make about 40 percent of its finished garments in any of its 20 factories, 18 of them clustered around its headquarters in La Coruña. Zara itself makes its most time- and fashion-sensitive products. Its factories are automated, specialize by garment type, and focus on the capital-intensive parts of the production process—pattern design and cutting—as well as final finishing and inspection. Zara spent 20 to 40 percent more, mainly due to higher labor costs, to make garments in Spain and Portugal than rivals spent in the Far East. Zara compensates by minimizing advertising, cutting inventory expenses, and quickly adjusting to fashion trends.

Many garments cannot be made by machine, but require a human touch. In response, Zara has built a network of some 500 workshops, located in Galicia, the home state of La Coruña, and across the border in northern Portugal that perform the labor- and scale-sensitive activity of sewing the garment pieces that were cut at the factories. These workshops are small operations averaging about 20 to 30 workers that specialize by product type. Zara accounts for most, if not all, of their business and provides tools, technology, logistics, and financial support while paying them standard rates per finished garment.

Zara's factories cut and color fabric of a particular garment. It then sends these pieces to the workshops, which then return the finished garments to Zara. Upon return, they are inspected, ironed, folded, bagged, and electronically tagged before traveling on hanging rails along 125 miles of underground tracks that link the various production sites.

LOGISTICS

All garments, both internally made and externally contracted, flow into Zara's massive distribution center in La Coruña or smaller satellite centers in Brazil and Mexico. Equipped with a mobile tracking system that docks hanging garments in the appropriate bar-coded area, and with carousels capable of handling 45,000 folded garments per hour, inventory moves from warehouses to Zara's worldwide network of 1,292 stores.

Driving the process are the twice-weekly deliveries to every Zara store, triggered by real-time inventory data collected through a network of Web-connected handheld computers. Lorena Alba, Inditex's director of logistics, regards the warehouse as a place to move merchandise rather than store it. According to her, "The vast majority of clothes are in here only a few hours," and none stay at the distribution center for more than three days. Third-party delivery services manage the transfer of preprogrammed lots to stores. This fancy digital footwork has dropped Inditex's inventory to 7 percent of annual revenues, compared with the mid- to high teens of its rivals.

MARKETING

Zara's trailblazing challenges age-old retail marketing practices. Its product policy emphasizes reasonable-quality goods, adaptable product lines, and high fashionability. The company uses little advertising or promotion—it spends less than 1 percent of its revenue on media advertising, compared with 3 to 4 percent for most specialty retailers. Instead, it relies on word of mouth among its legions of loyal shoppers.

Zara's pricing strategy, noted an analyst, is "Armani at moderate prices." It specializes in lightning-quick turnarounds of the latest designer trends at prices tailored to the young—an average of $27 an item in 2009. Explained Marcos Lopez of Inditex: "The key driver in our stores is the right fashion. Price is important, but it comes second."

Zara adjusts pricing for the international market, making customers in foreign markets bear the costs of shipping products from Spain. Zara's prices are 40 percent higher in northern European countries, 10 percent higher in other European countries, 70 percent higher in the Americas, and 100 percent higher in Japan.

STORE OPERATIONS

Besides selling its products, Zara's stores have two key tasks: present the company's face to the world and function as grassroots marketing research agents. The stores open in high-profile, premier shopping venues such as the Champs-Elysées in Paris, Regent Street in London, Fifth Avenue in New York, and Nanjing Road in Shanghai. Zara takes great care to put its best face forward. Regional teams of window dressers and interior coordinators visit each store every three weeks, ensuring that window displays and interior presentations convey the targeted message.

Back at headquarters, designers wander the mock store space and test possible themes, color schemes, and product presentation. These standards apply to the staff: Store employees wear Zara clothes while working; store managers and staff choose which merchandise to order, discontinue, and recommend. Zara equips salespeople with wireless handheld organizers that let them punch in trends, customer comments, and orders. Networked stores transfer data on merchandise sales, along with customer requests, to Zara's design teams, factories, and logistics center in La Coruña. Finding store managers capable of handling these responsibilities, according to CEO Castellano, is the single most important constraint on Zara's global expansion.

FIRM INFRASTRUCTURE

The infrastructure that Zara has built to coordinate these value activities is a key competency. There are many, but two stand out: managers' sense of customers and markets and their ability to coordinate activity worldwide.

Managers believe the allure of Zara is the freshness of its offerings, the creation of a sense of exclusiveness, an attractive in-store ambience, and positive word of mouth. These ideas drive rapid product turnover, with new designs arriving in twice-weekly shipments. Zara's fans learn which days of the week goods are delivered and shop accordingly. About three-quarters of the merchandise on display changes every three to four weeks. This corresponds to the average time between visits, given estimates that the average Zara shopper visits the chain 17 times a year—versus three to four visits per year for competitors.

Attractive stores, both inside and out, are an asset. As Luis Blanc, a director at Inditex, explains, "We invest in prime locations. We place great care in the presentation of our storefronts. That is how we project our image. We want our clients to enter a beautiful store where they are offered the latest fashions. But most important, we want our customers to understand that if they like something, they must buy it now, because it won't be in the shops the following week. It is all about creating a climate of scarcity and opportunity."

Rapid turnover fans a sense of "buy now because you won't see it later." Zara reinforces scarcity with small shipments, sparsely stocked shelves, and a display limit of one month. Rapid turnover means that consumers visit Zara three or four times a season rather than just once. These policies also keep Zara's shops looking fresh and reduce markdowns; the number of items that it puts on clearance sale is about half the industry average.

Managers' adept coordination of the overlapping activities among its designers, workers, salespeople, and plants testifies to the power of its strategy. No other company can ship new fashion designs to stores as speedily as Zara. Still, besides growing faster, Zara hits the same profit margins with higher sales per square foot than do its rivals. Zara's strategy and business design leave rivals with less time to figure out how to better configure and coordinate operations. Some believe that firms have little option but to follow Zara's strategic lead. If they don't, warns a leading retail analyst, they "won't be in business in 10 years."

Introduction

The first half of our text explains that international companies operate in an environment shaped by cultural, political, legal, economic, trade, monetary, governmental, and institutional forces. These forces comprise the environment of international business that sets the context for managers' actions (see Figure 11.2). It is this latter perspective—what managers do, given conditions and trends in the environment, to make their companies competitive—that anchors this chapter and the remainder of the text.

This chapter looks at how managers devise strategies to engage international markets that boost current performance and sustain long-term growth. Although commonalities that integrate countries create opportunities for companies, differences endure that constrain their actions. This chapter accepts this understanding and identifies factors that then influence managers' strategic analyses. Among them are the managers' evaluation of the idea of strategy, the tools that support their choices, and the processes that convert their vision into action.

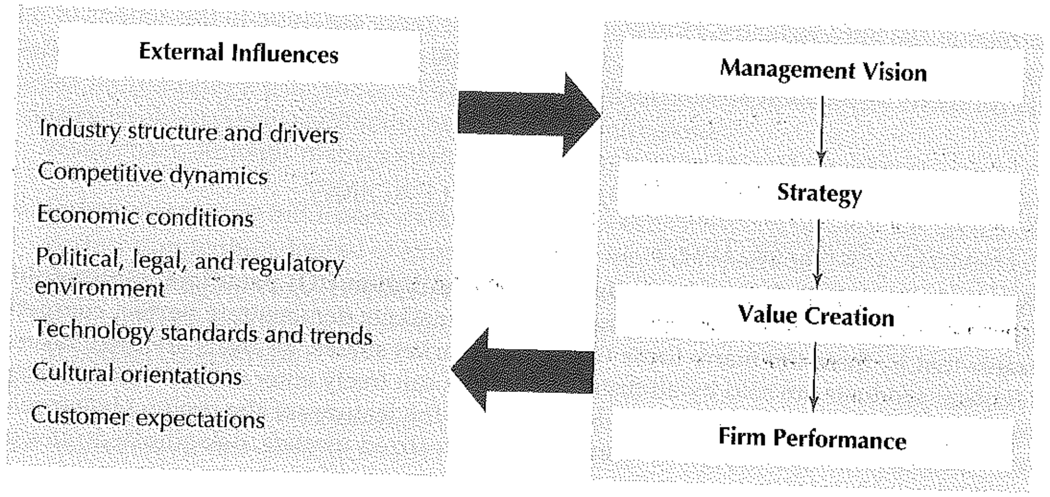

FIGURE 11.2 The Role of Strategy in International Business

In Chapter 1, we introduce the idea of the operating environment to encompass the physical/social and competitive factors that influence the external environment in which an international business conducts its operations. Among these operations, we include *strategy*: the means by which managers establish and sustain the company's competitive position within its industry. Beginning with the current chapter, we focus on the way in which a firm's strategy responds to as well as shapes the physical/social and competitive factors in its external environment.

The remaining chapters of our text elaborate the framework we build in Chapter 11. That is, our understanding of strategy guides the analysis of subsequent issues, including how firms enter foreign markets, make investments, form alliances, and organize activities. In the final section of the text, ideas from Chapter 11 anchor discussions of how MNEs design and implement their marketing, manufacturing, supply, accounting, finance, and human resource strategies.

Strategy is the framework that managers apply to determine the competitive moves and business approaches that run the company.

Revisiting Zara Our opening profile of Zara previews many of these issues. When Zara began its global expansion, for instance, strategy in the apparel business was dictated by the structure of the industry—a structure that was inefficient (it took too much time to design and deliver clothing) and ineffective (apparel makers and sellers were plagued by forecasting and inventory problems). Figure 11.1 (p. 435) shows that Zara rejected the conventions dictated by this structure and, over the next decade, developed an innovative strategy to reset the standards of operational efficiency and market effectiveness.

Zara's strategy changed the apparel industry in ways that redefine ideas of global integration (standardizing worldwide activities to maximize efficiency) and national responsiveness (adapting local activities to maximize effectiveness). More specifically, Zara changed how a company in the apparel industry creates value in design, manufacturing, logistics, and marketing. In addition, it reset standards regarding how a company coordinates the business functions that support value creation. Finally, Zara's long-running series of choices highlight the value of strategy for the international company—managing the tension between global integration and local responsiveness in converting strategy into superior value.

Concept Check

Recall that in Chapter 3 we rely on the dichotomy between **democracy** and **totalitarianism** and the idea of political freedom as a framework for integrating information about international business. In Chapter 4, we use the differences among **market, mixed,** and **command economies** and the notion of economic freedom to build a similar framework. A key framework in this chapter is the different ways managers study **strategy** within the context of industry structure and the configuration and coordination of value activities.

Industry, Strategy, and Firm Performance

Before profiling strategy in the MNE, we review fundamental features of strategic management. In specific, we look at the ideas of and relationships among industry, strategy, and firm performance. We begin by looking at the idea of an industry because it influences the profitability of the typical company. The forces in the MNE's environment that routinely have the greatest impact on its strategy are in its immediate industry environment. For example, BMW worries how trends in interest rates, changes in political leadership, and innovations in technologies affect the potential for

Strategy expresses management's idea on how to best

- Attract customers.
- Operate efficiently.
- Compete effectively.
- Create value.